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Scope of the proposed Standard on Regulatory Assets and Regulatory Liabilities Issues Paper

Objective

- 1 In October 2021, the IASB considered constituents' responses to the IASB Exposure Draft ED/2021/1 *Regulatory Assets and Regulatory Liabilities* ('ED') on the scope of the proposed Standard (see [IASB agenda paper 9A - Feedback Summary-Objective and Scope](#)). As mentioned in the cover note (agenda paper 01-01), the scope was highlighted as one of the significant topics of concern and thereafter designated as a priority topic for the IASB redeliberation.
- 2 The purpose of this paper is to inform and obtain EFRAG FR TEG members' views on the overall feedback received and the IASB tentative decisions on specific aspects of the scope of the proposed Standard taken in February and May 2022.
- 3 The rest of this paper is structured as follows:
 - (a) The ED's proposals on the scope of the proposed Standard
 - (b) Feedback received by the IASB on the scope of the proposed Standard
 - (c) IASB redeliberation and tentative decisions on scope
 - (d) IASB ASAF feedback
 - (e) EFRAG discussions on the IASB tentative decisions
 - (f) Appendix: Elaboration on IASB redeliberation on the scope of the proposed Standard

The ED's proposals on the scope of the proposed Standard

- 4 Paragraph 3 of the ED proposes that an entity applies the rate-regulated activities model to all its regulatory assets and regulatory liabilities.
- 5 Furthermore, paragraph 6 of the ED specifies that a regulatory asset and a regulatory liability can exist only if:
 - (a) an entity is party to a regulatory agreement;
 - (b) the regulatory agreement determines the regulated rate the entity charges for the goods or services it supplies to customers; and
 - (c) part of the total allowed compensation for goods or services supplied in one period is charged to customers through the regulated rates for goods or services supplied in a different period (that is, there are differences in timing).
- 6 Paragraph 7 of the ED defines a regulatory agreement as a set of enforceable rights and obligations that determine the regulated rate to be charged to customers. The

ED does not restrict the scope to regulatory agreements with a particular legal form, or that have particular features.

Feedback received by the IASB on the scope of the proposed Standard

EFRAG's Final Comment Letter position

- 7 In its final comment letter ('FCL'), EFRAG notes several aspects where there is a need for further clarification on entities' scope eligibility, including:
- (a) types of regulation where regulated rates are based on sector average costs instead of an entity's own costs (e.g., this is the case for the regional grid operators in the Netherlands). EFRAG expressed the view that such costs should be within the scope of the Standard;
 - (b) specific scope exclusions (e.g., for self-regulation, IFRS 17 *Insurance contracts*);
 - (c) specific guidance and examples on what constitutes a regulatory agreement and how an entity should assess whether rights and obligations created by the regulatory agreement are enforceable; and
 - (d) whether the existence of a regulator is required and better defining the characteristics of a regulator;
 - (e) more guidance (including illustrative examples) on the model's interaction with the requirements of IFRIC 12 *Service Concession Arrangements* (i.e. application of the intangible asset model under IFRIC 12 in combination with the proposed model, interaction with the proposed model in cases when an entity has a hybrid arrangement under IFRIC 12, treatment of a terminal value in a concession arrangement when the regulator provides some form of terminal value guarantee);
 - (f) definition of 'customers' as the notion of customers (i.e., groups of customers) is different to the notion of the customer under IFRS 15 *Revenue from Contracts with Customers*.

General feedback received

- 8 The general feedback received by the IASB on the scope of the proposed Standard is consistent with EFRAG's position in its FCL.
- 9 There was a general concern that the scope may be too broad. Many respondents were uncertain about which regulatory agreements, arrangements or activities would be within the scope of the proposals. Some of these uncertainties are due to:
- (a) The exclusion of some of the features of 'defined rate regulation' as described in paragraph BC82 of the ED (i.e. there is no effective competition to supply the regulated goods and services, the regulation establishes parameters to maintain the availability of the supply and provide greater price stability for customers and support the financial viability for the regulated entity).
 - (b) Not specifying whether a particular body, such as a regulator, is required for a regulatory asset or regulatory liability to exist may capture a wide range of activities and arrangements that should not be included in the scope.
 - (c) Difficulty in identifying the rights and obligations that may constitute a regulatory agreement.
 - (d) Uncertainty about whether particular features may cause a regulatory agreement to be within, or outside, the scope of the proposals.
 - (e) The interaction between the proposals and other Standards (mainly, IFRS 9 *Financial Instruments*, IFRS 17 and IFRIC 12). Respondents asked the IASB to develop detailed guidance and illustrative examples on how an entity would

account for regulatory assets and regulatory liabilities by applying either the financial asset, the intangible asset or a hybrid model in IFRIC 12.

- (f) The proposed definition of 'regulatory agreement' and whether a regulator is needed for regulatory assets or regulatory liabilities to exist. According to these respondents, both the broad proposed definition of 'regulatory agreement' and the lack of definition of 'regulator' may capture a wide range of activities and arrangements that should not be included in the scope and may make consistent application of the final requirements difficult. IASB redeliberations and tentative decisions on the scope of the proposed Standard
- 10 At its February and May 2022 meetings, the IASB started redeliberating specific aspects of the scope proposals dealing with:
- (a) the conditions for a regulatory asset or regulatory liability to exist and determining whether a regulatory agreement with particular features is in the scope (see related [IASB agenda paper 9B](#));
 - (b) the role, definition of the regulator and whether self-regulation is in scope (see related [IASB agenda paper 9C](#));
 - (c) application questions relating to the term 'customers' (see related [IASB agenda paper 9D](#));
 - (d) interaction of the RRA model with the requirements of IFRS 9 (see related [IASB agenda paper 9E](#)).
- 11 The IASB's tentative decisions on these topics are summarised in the paragraphs below and the reasoning for these decisions is included in Appendix 1.

Determining whether a regulatory agreement is within the scope of the proposals

- 12 The IASB tentatively decided:
- (a) to reconfirm the proposals in the ED:
 - (i) to require an entity to apply the Standard to all its regulatory assets and regulatory liabilities;
 - (ii) that the Standard will apply to all regulatory agreements and not only to those that have a particular legal form;
 - (iii) to confirm the conditions necessary for a regulatory asset or a regulatory liability to exist;
 - (b) to not explicitly specify in the Standard which regulatory schemes would be within or outside its scope;
 - (c) to clarify in the Standard that a regulatory agreement:
 - (i) may include enforceable rights and enforceable obligations to adjust the regulated rate beyond the current regulatory period;
 - (ii) that creates either regulatory assets or regulatory liabilities, but not both, is within its scope;
 - (iii) that causes differences in timing when a specified regulatory threshold is met creates regulatory assets or regulatory liabilities;
 - (iv) is not required to determine a regulated rate using an entity's specific cost for the regulatory agreement to create regulatory assets or regulatory liabilities (i.e. some incentive-based regulatory schemes may establish differences between the entity's actual costs and average costs of a group of industry peers (benchmarked costs) which are fully or partially shared between the entity and its customers).

Definition of a regulator and self-regulation

- 13 The IASB tentatively decided to:
- (a) include the existence of a regulator as part of the conditions necessary for a regulatory asset or a regulatory liability to exist;
 - (b) define a regulator as '*a body that is empowered by law¹ or regulation to determine the regulated rate or a range of regulated rates*';
 - (c) include guidance to clarify that:
 - (i) self-regulation is outside the scope of the proposed Standard; and
 - (ii) a situation in which an entity or its related party determines the rates, but does so in accordance with a framework that is overseen by a body empowered by law or regulation, is not self-regulation for the purposes of the proposed Standard.

Clarifications relating to the term 'customers'

- 14 The IASB tentatively decided to clarify that, for a regulatory asset or a regulatory liability to arise, it is necessary that differences in timing originate from, and reverse through, amounts included in the regulated rates that an entity accounts for as revenue in accordance with IFRS 15, even in cases when:
- (a) an entity charges the regulated rates to its customers indirectly through another party;
 - (b) the origination and reversal of differences in timing occur in different revenue streams through regulated rates charged to different groups of customers.

Interaction with IFRS 9 requirements

- 15 The IASB tentatively decided:
- (a) not to exclude from the scope of the proposed Standard regulatory assets or regulatory liabilities related to financial instruments within the scope of IFRS 9;
 - (b) to explain in the Basis for Conclusions on the proposed Standard that the regulation of interest rates is typically limited to setting a cap or floor on interest rates, therefore, this type of regulation is not expected to give rise to differences in timing.

Future IASB discussions on the scope of the proposed Standard

- 16 At future meetings, the IASB plans to continue its discussions related to the scope of the proposed Standard, including:
- (a) interaction with IFRS 17;
 - (b) application questions about the definition of 'regulatory agreement' and the term 'customers';
 - (c) boundary between financial instruments and regulatory assets and regulatory liabilities;
 - (d) interaction with IFRIC 12;

¹ The proposed definition of a regulator is a modification to the definition of a regulator in IFRS 14 *Regulatory Deferral Accounts*: '*An authorised body that is empowered by statute or regulation to establish the rate or a range of rates that bind an entity. The rate regulator may be a third-party body or a related party of the entity, including the entity's own governing board, if that body is required by statute or regulation to set rates both in the interest of the customers and to ensure the overall financial viability of the entity.*' The change is to eliminate the confusion that 'statute' referred to the articles of incorporation of a company were in scope of the model.

- (e) enforceability of rights and obligations to adjust future regulated rates - to be discussed when redeliberating recognition and measurement.

IASB ASAF feedback

- 17 In March 2022, the IASB consulted ASAF on its redeliberation plan and tentative decisions on scope. ASAF members broadly supported the IASB plans and made suggestions including merging the redeliberation of scope and total allowed compensation; for the IASB to share the enhanced wording of scope; and clarifying the interaction of the scope with IFRIC 12.

EFRAG's initial discussions on IASB's redeliberation plan and tentative decisions on the scope of the proposed Standard

- 18 The IASB's direction of deliberations on scope are in line with the EFRAG's recommendations in its [final comment letter](#). In particular:
- (a) *regulatory agreement* – clarifying the characteristics of a regulatory agreement will help entities determine whether they are in the scope of the proposed Standard and whether rights and obligations created by the regulatory agreement are enforceable;
 - (b) *definition of a regulator* - being explicit whether the existence of a regulator is required and having guidance on who the regulator is would be helpful;
 - (c) *self-regulation* - will be helpful to set specific scope exclusions (e.g., for self-regulation);
 - (d) *term 'customers'* – clarifying who the 'customers' are in the context of the rate-regulated activities project helps scoping the project;
 - (e) *interaction with IFRS 9* – specifying the interaction with IFRS 9 requirements improves the clarity on scope.
- 19 In March 2022, in preparation for the IASB ASAF meeting, the EFRAG FR TEG-CFSS received an update on the IASB redeliberation plans and tentative decisions on the scope of the proposed Standard. Members did not object to the IASB plans, they agreed that the scope of the proposed Standard was a critical starting point for resolving some of the other concerns raised (e.g., the applicability of total allowed compensation proposals for costs that are not entity-specific such as sectoral average costs). Some members sought clarification on:
- (a) how the tentative decisions on scope affected self-regulation (i.e., a transfer pricing arrangement between a parent company and its subsidiary);
 - (b) whether some of the concerns raised by constituents were addressed - including concerns on the recognition threshold that differs from that of IFRS 15 and the detailed disclosures requirements;
 - (c) whether a limited re-exposure of the proposals on scope might be helpful. A view was expressed that it is too soon to make such a determination and it is likely that the IASB will focus on outreach to formulate solutions rather than to re-expose the ED.
- 20 In April 2022, the EFRAG FR Board received an update on the IASB's redeliberation plans and tentative decisions. The following points of discussion arose:
- (a) A member questioned the expected need to clarify the interaction with IFRS 17 and whether this would lead to unintended consequences especially if one considers the proposed Standard is a supplementary Standard. It was indicated that the IASB will address the interaction of the proposed Standard with other IFRS Standards at future meetings and is in the process of gathering evidence/fact patterns on the interaction with IFRS 17. A note was

Scope of RRA project - Issues Paper

made that no detailed fact patterns on the possible impact on insurance entities had been obtained during the consultation period including through the outreach to the EFRAG IAWG.

- (b) Another member questioned whether scope exclusion was necessary as regulatory assets and regulatory liabilities meet the definition of assets and liabilities in the *Conceptual Framework*. The member expressed the view that all regulatory agreements regardless of the sector should be within the scope of the proposed Standard and, in addition, expressed concerns about cooperative arrangements in Denmark potentially falling out of scope. Another member observed the wording of the scope included governmental bodies that could be related parties to a provider of utility services.
- (c) It was agreed that there will be a need to assess the amended wording of the scope to better understand the implications of who is in or out of scope.

21 In April 2022, EFRAG consulted with the EFRAG RRAWG regarding the IASB's redeliberation on scope which included discussions on the IASB's tentative decisions included in paragraphs 12 and 13 of this agenda paper. Members welcomed the IASB's direction of redeliberation on scope and made the following comments:

- (a) *Determining whether a regulatory agreement is within the scope* – members considered that clarifying that a regulatory agreement might include enforceable rights and enforceable obligations to adjust the regulated rate beyond the current regulatory period was relevant for defining the scope of the model;
- (b) *Definition of a regulator* - members were supportive of adding the regulator as a necessary condition for the existence of regulatory assets and regulatory liabilities and agreed with the proposed definition of a regulator;
- (c) *Self-regulation* - members agreed with the IASB decision that self-regulation should stay outside of the scope of the proposed Standard and also agreed with the clarification that self-regulation for the purposes of the Standard excluded situations where a related party determined the regulated rates in accordance with a framework that was overseen by a body empowered by law or regulation.

Question for EFRAG FR TEG

22 Does EFRAG FR TEG agree with the IASB's tentative decisions summarised in paragraphs 10 to 15?

Appendix: Elaboration on IASB redeliberation on the scope of the proposed Standard

23 The IASB considered the feedback received from respondents on the proposals on the scope and tentatively decided on:

- (a) *Determining whether a regulatory agreement is within the scope of the proposed model*
- (i) to confirm paragraph 3 of the ED and include it in the final Standard – this is because respondents broadly supported this scope proposal, subject to specific scope exclusions. Furthermore, the approach to the scope of the proposed Standard was seen as efficient by ensuring the inclusion of different types of regulatory schemes without needing to identify and define them and helps avoid sector-specific accounting;
 - (ii) not adding the remaining features of ‘defined rate regulation’ - for the reasons already considered in the ED (a narrower scope would not produce more useful information about the effects of rate regulation and the assessment of whether such features are present would be difficult and highly subjective) and limited concerns expressed by respondents;
 - (iii) not to specify the legal form of the regulatory agreement - specifying the legal form of regulatory agreement might unintendedly narrow the scope considering the diverse rate-regulatory schemes across jurisdictions and industries. Most respondents agreed that the proposed requirements should apply to all regulatory agreements and not only to those that have a particular legal form;
 - (iv) to clarify that a regulatory agreement can include enforceable rights and enforceable obligations to adjust regulated rates beyond the current regulatory period – some regulatory agreements give rise to enforceable rights and enforceable obligations that result in adjustments to future regulated rates beyond the current regulatory period, i.e. pension costs to adjust future regulated rates only when cash is paid in future regulatory periods;
 - (v) not to specify that a particular regulatory scheme, such as a price cap regulation, does not give rise to any regulatory asset or regulatory liability – this is because the scope proposals are clear that for a regulatory asset or regulatory liability to exist there needs to be differences in timing. Specifying that certain types of arrangements are not within the scope risks that a regulatory scheme labelled in a particular way and creating differences in timing to be excluded from the scope of the final Standard;
 - (vi) to clarify that a regulatory agreement that gives rise to asymmetric rights and obligations is within the scope of the model – although the scope proposals do not require that a regulatory agreement creates both regulatory assets and regulatory liabilities, the IASB Staff recommended that the final Standard clarifies that following concerns raised by respondents;
 - (vii) to clarify that regulatory agreements that give rise to differences in timing when a specified regulatory threshold is met are within the scope of the final Standards – this is to avoid uncertainties arising from regulatory agreements that provide some flexibility to the entity for determining the rate but include regulatory thresholds that cause differences in timing to arise;

- (viii) to clarify that the regulated rate does not need to be determined using an entity's costs for it to be within the scope - regulatory agreements in which the regulated rate is determined using benchmarked costs are not scoped out of the ED's proposals. However, due to uncertainty concerns raised by respondents, the IASB Staff proposes this point be clarified in the final Standard;
- (b) *Definition of a regulator*
- (i) to include the existence of a regulator as part of the conditions necessary for a regulatory asset or a regulatory liability to exist – this is to address concerns of respondents related to the uncertainty of the application of scope proposals, to exclude self-regulation from the scope and to limit structuring opportunities through transfer pricing agreements or commercial contracts between private companies;
 - (ii) to define the regulator as '**a body that is empowered by law or regulation to determine the regulated rate or a range of regulated rates**' – the proposed definition of a regulator was developed considering suggestions made by respondents and the definition of a regulator contained in IFRS 14. The IASB consider whether the definition should be based on features such as the regulator being independent third-party and/or acting objectively in accordance with rules or regulation, however, established that without a detailed explanation of these terms, the definition of regulator could be interpreted and applied differently across different jurisdictions. Moreover, defining independence and/or objectivity would be challenging. In addition, in some jurisdictions, the regulator and the regulated entity are related parties as defined in IAS 24 *Related Party Disclosures* because they are controlled by the same government, therefore, establishing such a feature would exclude such regulatory schemes from the scope of the model. Lastly, the IASB decided to replace the term 'statute' used in the definition of the regulator in IFRS 14 with the term 'law', because it was indicated by respondents, including EFRAG, that the term 'statute' was considered to refer to the articles or statute of incorporation of a company. Such an interpretation of 'statute' could lead to some agreements (i.e. intercompany agreements) being in the scope of the proposed model;
 - (iii) to keep the determination of the regulated rate as a main function of the regulator – although regulators may have a variety of functions (i.e. provide rate stability for customers or maintain the availability and quality of the supply of goods or services), the determination of the regulated rate to design or establish the basis for the calculation of the rate and subsequently approve the final rate is the most relevant for the model;
 - (iv) to keep the expression '*rate or range of rates*' from IFRS 14 in the definition of the regulator – this is to address situations in which the regulator provides the regulated entity with some discretion or flexibility in determining the rate (i.e. different rates for different types of customers). However, this discretion is restricted by boundaries set by the regulator.
- (c) *Self-regulation*
- (i) to clarify that self-regulation is outside the scope of the proposed Standard. Furthermore, to provide guidance and clarify that cases when an entity determines its own rates (i.e. some co-operatives) or related parties (i.e. an entity's own governing board) determine the rate but in both cases, they do so in accordance with a framework that is overseen

Scope of RRA project - Issues Paper

by a body empowered by law or regulation are within the scope of the proposed Standard.

- (d) Clarifications on the term 'customers'
 - (i) to clarify that, for a regulatory asset or a regulatory liability to arise, it is necessary that differences in timing exist when an entity accounts for revenue in accordance with IFRS 15. It was cautioned that the drafting of the proposed Standard should avoid implicitly being interpretive guidance on how to apply IFRS 15 requirements.
- (e) Interaction with IFRS 9 requirements
 - (i) there was broad support for not providing a scope exclusion for regulatory assets or regulatory liabilities related to financial instruments within the scope of IFRS 9 because there were no examples of situations in which a regulatory asset or a regulatory liability would arise from financial instruments that have a regulated interest rate.